

STATE INVESTMENT COMMISSION
December 15, 2006

MINUTES

The State Investment Commission was called to order by Jonathan Miller, State Treasurer, on Friday, December 15, 2006 in Room 76 of the Capitol Annex at 1:00 p.m. Members present were Jennifer Sheehan, proxy for John Farris, Secretary, Finance and Administration Cabinet; David Fleenor, proxy for Governor Ernie Fletcher; and Jonathan Miller, State Treasurer.

Treasurer Miller verified that a quorum was present and that the press had been notified of the meeting.

At this time Treasurer Miller issued the Oath of Office, to George Spragens, President and CEO of Farmers National Bank, Lebanon, Kentucky who was appointed by Governor Fletcher to the State Investment Commission to replace James O. King who resigned.

Treasurer Miller called for a motion to approve the minutes of the September 28, 2006 meeting. Doug Fleenor moved and Jennifer Sheehan seconded. Motion carried unanimously.

The first item on the agenda was the TRAN update. Steve Jones, Portfolio Administrator, Office of Financial Management began by stating that UBS was incorrectly identified as the counterparty on the interest rate swap but the counterparty is actually J. P. Morgan. He added that the swap is performing as expected and has resulted in approximately \$1 million in net income to date. Mr. Jones expected that the net income would reach the projected \$2 million by the end of the year.

F. Thomas Howard, Executive Director, Office of Financial Management noted that the expenditure test had been met on the debt side of the swap. Mr. Howard pointed out that by meeting the expenditure test the Commonwealth would be able to keep the excess earnings.

The next item on the agenda was the Interest Rate Steepener Swaps. Mr. Jones stated that the Commonwealth entered into two interest rate swaps in June 2006 which were expected to perform well if the yield curve steepened. Mr. Jones stated that this transaction is a partial hedge of a number of positions in the investment portfolio. Mr. Jones informed the members that to this point in time, the yield curve has not steepened which has resulted in a marked to market of negative \$104,000 as of close of business December 12, 2006. Mr. Jones stated that the Commonwealth is earning about \$.50 per day for the transaction. Mr. Jones stated that the yield curve is expected to steepen at some point and when that happens this should result in a net gain for the Commonwealth.

Mr. Howard pointed out that this position is an insurance premium, if you will, used to project against the deteriorating value of other assets. He continued that if the curve were to steepen the Commonwealth would lose value in other securities and this is only a small hedge for a portion of the assets to preserve the market value.

Treasurer Miller asked if the assets that they were hedged against were doing well. Mr. Jones indicated that the assets were doing well. He stated that spreads continued to tighten across the portfolio, and that the bonds held in the portfolio are appreciating slightly from the tightening of the spreads.

The next item on the agenda was Resolution SIC-06-01:

**A RESOLUTION OF THE STATE INVESTMENT COMMISSION OF
THE COMMONWEALTH OF KENTUCKY APPROVING THE
EXTENSION OF THE SECURITIES LENDING CONTRACT FOR THE
YEAR BEGINNING FEBRUARY 1, 2007 AND ENDING JANUARY 31,
2009.**

Dwight Price, Portfolio Administrator, Office of Financial Management, indicated that staff would like to extend the current contract with Credit Suisse for the Commonwealth's securities lending program. He stated that the annual earnings on the securities lending program was approximately \$2.5 million yearly. Mr. Price pointed out that an RPF for these services could be issued, but that the current contract allows for an extension. He further stated that the relationship between the Commonwealth and Credit Suisse has been profitable and it would be in the best interest of the Commonwealth to extend their contract for an additional two years and then issue an RFP in January 2009 when that contract expires.

Treasurer Miller called for a motion to adopt Resolution SIC-60-01 to extend the securities lending contract with Credit Suisse for the period beginning February 1, 2007 and ending January 31, 2009. Jennifer Sheehan moved and Doug Fleenor seconded. Motion carried unanimously and Resolution SIC 06-01 was **ADOPTED**.

With no further business before the Commission George Spragens moved to adjourn. Motion carried unanimously.

Respectfully submitted,

F. Thomas Howard
Secretary